



## Hong Kong Tax Newsflash

### Tax deductions for capital expenditure on intellectual property under consultation

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The Hong Kong government has recently launched a stakeholder consultation on profits tax deductions for capital expenditure related to intellectual property (IP). This initiative was proposed in the 2025-26 Budget, in which the government announced plans to review tax deductions related to the purchase of IP and lump sum licensing fees for the right to use IP.

#### Acquisition costs of IP from associates

Currently, no tax deduction is allowed for capital expenditure on IP acquired wholly or partly from an associate. The original intention of this rule was to tackle possible tax avoidance.

To promote the development of IP trading in Hong Kong, it is proposed to relax this rule by expanding the scope of the profits tax deduction for capital expenditure incurred for the purchase of eight types of IP<sup>1</sup> to include acquisitions from associates, subject to the following anti-avoidance measures:

- **Main purpose test:** No deduction will be allowed if the main purpose or one of the main purposes of the acquisition is to obtain a tax benefit<sup>2</sup>. If tax benefit is only an incidental consequence of the transaction, the obtaining of tax benefit will not be regarded as a main purpose.
- **Domestic intra-group transfers:** Such transactions will be carved out from the domestic transaction exemption<sup>3</sup> for transfer pricing purpose and will be required to comply with transfer pricing rules and documentation requirements<sup>4</sup>. The sales proceeds received by the transferor, less any deductions (in respect of the IP) not yet allowed, will be treated as a taxable trading receipt to prevent excessive tax deductions.
- **Valuation report:** A third-party independent valuation report will be required upon request by the Inland Revenue Department (IRD) if the acquisition cost of the IP is HKD 3 million or more. The report must be prepared by a qualified, independent valuer. The purpose is to ensure that the acquisition cost is at an arm's length price.

<sup>1</sup> i.e. patent rights, rights to know-how, copyright, performer's economic rights, protected layout-design (topography) rights, protected plant variety rights, registered designs and registered trade marks

<sup>2</sup> Tax benefit means an avoidance, postponement or reduction of a liability to pay tax chargeable under the Inland Revenue Ordinance.

<sup>3</sup> Domestic transactions between associated persons which do not give rise to actual tax difference, or relate to interest-free loans which are not granted in the ordinary course of money lending or intra-group financing business, provided that such transactions do not have a tax avoidance purpose. Such transactions are exempted from compliance with the transfer pricing rules.

<sup>4</sup> The exemption on transfer pricing documentation for transfer of intangibles below HKD110 million remains applicable.

- **Other anti-abuse provisions:** Other existing anti-abuse provisions will remain applicable. For example, no deduction will be allowed for the acquisition of IP used by a licensee outside Hong Kong, unless the Hong Kong taxpayer uses by itself the IP in cross-border activities that produce assessable profits in Hong Kong.

## Upfront licence fees for the right to use IP

Under the existing rules, upfront licence fees (i.e. a lump sum payment to be made initially) are regarded as capital in nature and not deductible.

To encourage the development and commercialization of IP, it is proposed to allow a tax deduction for upfront licence fees incurred for the right to use IP in a licensing arrangement, subject to the following conditions:

- **Forms of licences:** Eligible licences include exclusive<sup>5</sup>, sole<sup>6</sup>, and non-exclusive licences.<sup>7</sup>
- **Types of IP:** The deduction will cover the same eight types of IP<sup>8</sup> under the existing tax deduction regime for IP.
- **Deduction period:** The deduction will be spread evenly over the licensing term. If the term is amended, the remaining deduction will be spread over the revised remaining term.
- **Claw-back arrangement:** Where a licence is terminated or assigned, any excess of proceeds over the unallowed amount will be treated as a taxable receipt, capped at the deduction previously allowed. If the license fee is reduced upon amendment of the arrangement, any excess of aggregate deductions claimed over the revised fee will be clawed back.
- **Deeming provision:** Any sums, not otherwise chargeable to profits tax, received by or accrued to a Hong Kong licensor in relation to the right to use IP will be deemed as a taxable trading receipt so as to ensure tax symmetry.
- **Anti-avoidance measures:** The IRD will be empowered to determine the arm's length price of the upfront licence fees, request submission of a valuation report, and allocate consideration when the licence is acquired, assigned or terminated with any other dealings.

## Legislative timeline

The government plans to introduce the amendment bill into the Legislative Council within 2026 to implement the above proposals.

## Our observation

We welcome the government's proposals to expand the scope of IP-related tax deductions, which may help rectify the long-standing tax asymmetry between the taxability of IP-related income and the deductibility of associated expenses.

<sup>5</sup> An exclusive licence refers to a licence under which the licensee is the only person authorised to exploit the IP, and even the IP owner cannot exploit the IP.

<sup>6</sup> A sole licence refers to a licence under which the licensee is the only person that is granted a licence to exploit the IP, while the IP owner retains the right to exploit the IP.

<sup>7</sup> A non-exclusive licence refers to a licence that may be granted to more than one licensee, while the IP owner may also exploit the IP.

<sup>8</sup> i.e. patent rights, rights to know-how, copyright, performer's economic rights, protected layout-design (topography) rights, protected plant variety rights, registered designs and registered trade marks

Similar to other preferential tax regimes, a main purpose test is proposed for the tax deduction of capital expenditure on IP acquired from associates. While the government has clarified that its intention is to target abusive arrangements lacking commercial substance, rather than discourage genuine business activities from benefiting from the deductions, uncertainty remains regarding the practical application of the test.

We note that, as an anti-avoidance measure, the sales proceeds received by the transferor of IP, less the amount of deduction not yet allowed, will be treated as a taxable trading receipt. If the deduction amount includes any previously unclaimed acquisition costs, this means IP acquisition costs which were non-deductible under the current rules could become deductible upon transfer, even if they were incurred before the new regime takes effect. If this interpretation is correct, it would be welcome news for taxpayers considering restructuring their IP ownership and management frameworks in Hong Kong.

Regarding the requirement for a third-party independent valuation report for IP valued at HKD 3 million or more, the threshold appears low given the typically high value of IP assets. It may impose unnecessary compliance burdens for small-scale transactions. Additionally, challenges may arise in how the value of IP should be estimated to assess whether a valuation report is required. Further guidance should be provided on the acceptable preliminary valuation methodologies.

Separately, subject to the drafting of the legislation, the deeming provision for upfront licensing income may extend the IRD's taxing rights to certain capital receipts and offshore-sourced income that would otherwise fall outside the Hong Kong profits tax net. Clarifications should be sought during the consultation period to avoid unintended tax liabilities that are outside the scope of tax symmetry. Overly stringent anti-abuse measures may reduce the effectiveness of preferential tax regime and hinder the intended objective of the policy.

The consultation is set to close on 31 March 2026. Stakeholders are encouraged to actively participate in the consultation process to help shape final rules that strike the right balance between preventing tax abuse and supporting legitimate business growth. In the meantime, businesses should closely monitor developments and assess how the proposed changes may impact their IP strategies.

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## Authors

### **Doris Chik**

Tax Partner

+852 2852 6608

[dchik@deloitte.com.hk](mailto:dchik@deloitte.com.hk)

### **Carmen Cheung**

Senior Tax Manager

+852 2740 8660

[carmcheung@deloitte.com.hk](mailto:carmcheung@deloitte.com.hk)

### **Kiwi Fung**

Tax Manager

+852 2258 6162

[kifung@deloitte.com.hk](mailto:kifung@deloitte.com.hk)

For more information, please contact:

### **Tax & Business Advisory**

#### **Southern Region Tax Leader**

##### **Jennifer Zhang**

Tax Partner

+852 2258 6228

[jennifzhang@deloitte.com.hk](mailto:jennifzhang@deloitte.com.hk)

#### **Hong Kong Tax Leader**

##### **Anthony Lau**

Tax Partner

+852 2852 1082

[antlau@deloitte.com.hk](mailto:antlau@deloitte.com.hk)



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